THE ECONOMIC ROLE OF SMES IN WORLD ECONOMY, ESPECIALLY IN EUROPE

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Abstract: Small and medium-sized enterprises (SMEs) are a very heterogeneous group of businesses usually operating in the service, trade, agri-business, and manufacturing sectors. They include a wide variety of firms such as village handicraft makers, small machine shops, and computer software firms that possess a wide range of sophistication and skills. Some are dynamic, innovative, and growth-oriented while others are satisfied to remain small and perhaps family owned. SMEs usually operate in the formal sector of the economy and employ mainly wage-earning workers. SMEs are often classified by the number of employees and/or by the value of their assets. The size classification varies within regions and across countries relative to the size of the economy and its endowments. It is important to note that there is a minimum as well as a maximum size for SMEs.

From small to giant companies – some samples

Take a look at any big company. Now, look back through time and track down when the company actually began. Not too many were born the size of the National Federal Bank or Procter&Gamble. Almost every company we know of began as an SME. The all-powerful Microsoft began as a couple of guys in a small garage in North-America; Vodafone as we know it today was once a little spin-off from Racal; Hewlett-Packard started in a little wood shack; Google was begun by a couple of young kids who thought they had a good idea; even Volkswagen at one point was just a little car maker in Germany (as opposed to being a giant small car maker globally).

Everything is up to points of view

The whole issue of SMEs is one of scale. A company of 20 people is viewed as an SME to a company of 500; and a company of 500 might be viewed as an SME to one of 5,000; and as well, you get the picture. But at some point in time, most companies were small and medium enterprises. Companies usually start because someone has what they think is a good idea. They take that good idea, and with commitment to it, go out and find customers who want it, and they are in business. Starting a business is bloody hard work, and when (and if) you get through the first year or two, you begin to run up against bigger businesses. And this is where running an SME becomes less than fun in some cases.

SMEs provide products and services that the big competitors don't for one reason or another. Perhaps it is because the market place is too small. SMEs deliver what no one else seems to want to deliver, and in many cases, they do it very well. Then why is it that many large companies treat SMEs like indentured servants that can be pushed around with

(sometimes) unreasonable demands? The only reasons we can think of are firstly; a sense of power, and/or secondly; they forget that without SMEs out there, many big companies would not be able to deliver what they promise to customers.
Having the 'power' over smaller companies can be a nice thing. You get to decide what you want, when you want it, how you want it, and what you will pay for it. All fine. But when you press SMEs too far, you run the risk of driving them into the ground, and without them, you might find yourself in a fine mess. If a big company has a reputation of beating SMEs into submission, word can get around, and what used to be a fertile ground of SMEs to choose from may become a deserted wasteland.

SME regulation in EU
The best description of the key characteristics of a small firm remains that used by the **Bolton Committee** in its 1971 Report on Small Firms. This stated that a small firm is an independent business, managed by its owner or part-owners and having a small market share.

The Bolton Report also adopted a number of different statistical definitions. It recognised that size is relevant to sector - i.e. a firm of a given size could be small in relation to one sector where the market is large and there are many competitors; whereas a firm of similar proportions could be considered large in another sector with fewer players and/or generally smaller firms within it.

Similarly, it recognized that it may be more appropriate to define size by the number of employees in some sectors but more appropriate to use turnover in others. Across government, it is most usual to measure size according to numbers of full-time employees or their equivalent.

The **Companies Act in the UK** of 1985 states that a company is 'small' if it satisfies at least two of the following criteria: (Small Business Service, UK)

- a turnover of not more than £5.6 million;
- a balance sheet total of not more than £2.8 million;
- not more than 50 employees

A medium sized company must satisfy at least two of the following criteria:

- a turnover of not more than £22.8 million;
- a balance sheet total of not more than £11.4 million;
- not more than 250 employees

For statistical purposes, the Department of Trade and Industry in he UK and governments all-around EU usually uses the following definitions:

- micro firm: 0 - 9 employees
- small firm: 0 - 49 employees (includes micro)
- medium firm: 50 - 249 employees
- large firm: over 250 employees

However, in practice, schemes which are nominally targeted at small firms adopt a variety of working definitions depending on their particular objectives. In February 1996, the

European Commission adopted a communication setting out a single definition of SMEs. The Commission now applies this across Community programmes and proposals. The communication also includes a (non-binding) recommendation to Member States, the European Investment Bank and the European Investment Fund encouraging them to adopt the same definitions for their programmes. The communication permits them to use lower threshold figures, if desired. The communication explains that existing SME definitions in Community programmes may continue to be used unti31 December 1997. After that date, the single definition must be used. The single definition must be used if programmes are modified in the meantime. (On 6 May 2003 the Commission adopted a new Recommendation 2003/361/EC regarding the SME definition which will replace Recommendation 96/280/EC from 1 January 2005. The thresholds for the number of employees remain unchanged but changes were made to the financial thresholds.)

In general, statistical definitions of a small to medium sized enterprise (SME) use one or other of three defining measurements; number of employees, turnover, or the size of the balance sheet. As shown in the table below, *The European Commission* revised its definition of SMEs in May 2003, taking into account economic developments since 1996 and the application of the definition. This was an attempt to ensure that enterprises that were part of a larger grouping did not benefit from SME support schemes. An increase in the financial ceilings was also designed to avoid penalizing enterprises that invest, though this is unlikely to increase the number of SMEs significantly. These categories are also used in Hungary from the beginning 2005.

Enterprise category	**Headcount**	**Turnover or balance sheet total**
Micro	Less than 10	Less than euro 2 million
Small	Between 10 and 49	Euro 10 million to 49 million
Medium	Between 50 and 250	Euro 50 million and up

Table 1. Enterprise categories in EU

In the European Union today, SMEs are economically important with 98% of an estimated 19.3 million enterprises defined as SMEs, providing around 65 million jobs. Again, almost all of these are small enterprises, with 18 million enterprises (93.2%) employing less than ten people and only 35,000 enterprises employing more than 250 people. **The average European business provides employment for four people, including the owner/manager.**

Figures show that SMEs account for roughly two thirds (66%) of employment within the EU, with micro enterprises accounting for 34%, small enterprises accounting for 19% and medium-sized enterprises accounting for 13%; more than half (52%) of private sector turnover within the EU, average turnover being approximately 500,000 Euros (EUROSTAT 2003).

The Position of SMEs in Europe-19

93 % of all European enterprises have less than 10 employees. There are 20.5 million enterprises in the European Economic Area (EEA) and Switzerland, providing employment for 122 million people. Some 93 % of these enterprises are micro (0-9 employees), 6 % are small (10-49), less than 1 % are medium-sized (50-249) and only 0.2 % are large enterprises (250+). Of all these enterprises nearly 20 million are established within the European Union. Two thirds of all jobs are in SMEs, so one third of all jobs is provided by large enterprises. Within SMEs, total employment is split up roughly equally between micro enterprises (employing less than 10 employees), and small and medium-sized enterprises. (Competence development in SMEs. 2003 Observatory of European SMEs 2003/1 Eurorean Comission.)

The size-class distribution of employment differs, however, between countries. For example, the share of micro enterprises in total employment is 48 % in Italy, and 57 % in Greece. On the other hand, the share of large enterprises in total employment is over 45 % in Ireland the United Kingdom.

		SME	Large	Total
Number of enterprises	(1000)	20.415	40	20.455
Employment	(1000)	80.790	40.960	121.750
Persons employed per enterprise		4	1.020	6
Turnover per enterprise	Million €	0,6	255,0	1,1
Share of exports in turnover	%	13	21	17
Value added per person employed	€ 1000	65	115	80
Share of labour cost in value added	%	63	49	56

Table 2. Basic facts about SMEs and large enterprises in Europe-19; 2000

Source: Estimated by EIM Business & Policy Research; estimates based on Eurostat' s SME Database. Also based on European Economy, Supplement A, June 2001 and OECD: Economic Outlook, No. 65, June 2001.

The average European enterprise employs 6 people

On average, an enterprise in Europe - even including all very large enterprises- provides employment to 6 people; the average for SMEs only is 4 people. However, this varies between 2 people in micro enterprises, and over 1 000 in large enterprises. Between countries, there are large differences as well. On average, an enterprise has 2 occupied persons in Greece and in Hungary too; and 3 in Italy, compared with 10 in Ireland, Luxembourg, Austria and the Netherlands.

Most jobs in Europe are created by micro enterprises

On balance, large enterprises lost jobs between 1988 and 2001, while employment in the SME-sector increased. In the early years this growth was concentrated in micro and small enterprises, as significant employment growth in medium-sized and large enterprises only started in 1997. In 2001, employment growth slowed down, because of world economy decrease. Current estimates show that this occurred both in SMEs and large enterprises, but the slow down is slightly more pronounced in large enterprises.

Of the 19.3 million enterprises in the European Union (EU) today, 99.8% are defined as SMEs and employ some 75 million people. There are only 35,000 enterprises, with more than 250 employees, but 18 million enterprises employ fewer than 10 people - the micro-enterprises. The average European business provides employment for 4 people, including the owner/manager, the average turnover being 500,000 euro (6th Annual Report of the European Small Business Observatory)

On a global scale, small and medium-sized enterprises provide some 66% of jobs in the European Union (EU) - a percentage which is predicted to rise as SMEs face challenges and opportunities associated with increased globalisation, largely through e-commerce and greater Internet usage by entrepreneurs. In the last decade, SMEs were the principle creators of new jobs, whilst on average; big industry has downsized and reduced employment. EU SMEs currently generate 56.2% of the private sector turnover.

Size	Employees	Percentage
Micro	10	93.0%
Small	10-49	5.9%
Medium	50-249	0.9%
SMEs		99.8%
Large	249 +	0.2%

Table 3. Percentage of employment by size of business in EU

Size	Employees	Share
Micro	2	34%
Small	20	19%
Medium	90	13%
Large	1025	34%

Table 4. Average enterprise size and employment by size class in EU

SMEs in the UK

There are 3.7 million businesses in the UK, or one for every ten people of working age. Of those businesses, 99.8 per cent have fewer than 250 employees. Only 31,000 businesses have 50 or more employees. One in eight of the workforce, or 2.3 million businesses, are self-employed.

The United Kingdom has a large business population by international standards although it has fewer small employers (as opposed to sole traders) than Italy or Germany. 24,000 businesses were medium sized (50 to 249 employees) and almost 7,000 were large (over 250 employees). The latter group accounted for 45% of non-government employment and

49% of turnover. Women are now responsible for a third of all business start-ups, an increase of over 22% over the last 4 years. (Barcleys Bank Report December 2000.)
SMEs are crucial to the UK's economy. Businesses with under 250 employees account for 56% of the UK non-government jobs and 52% of turnover. This is a smaller share than any other European Union country, partly due to a greater proportion of employment in large corporations in the UK than elsewhere in the EU. Many smaller businesses in the UK make a vital contribution to innovation. They do so as originators of new ideas and technologies; as links in supply chains promoting technical advances; and as sources of knowledge and specialized goods and services for larger businesses. Small businesses accounted for a higher proportion of employment in some industries including agriculture, business activities and construction.

Small businesses are recognised as the backbone of the British economy, accounting for more than half of the UK's turnover. Businesses employing fewer than 50 people account for 37 per cent of UK turnover and 44 per cent of private sector employment. But failures are frequent and often are thought to be due to management and leadership weakness. In addition, smaller businesses have little time to navigate through the confusing variety of training schemes available, and are often unable to cope easily with the way training is delivered. (Small and Medium Enterprise (SME) Statistics for the UK, 1999 URN 00/92)

SMEs in the ten new EU member countries
Until 1st May 2004 these countries were the candidate countries. There are many theories as to what impact this may have on the other EU countries. New opportunities will arise for SMEs in all of the countries concerned via collaboration and import/export. A common concern is that there will be a 'brain drain' away from these countries into the existing member states and there is also a worry that vast unemployment (around 25% for the under 25s in Poland, which also has the largest population of the accession countries) will lead to an influx of people seeking work. In theory, this could mean increased competition for work in the UK, but on the other hand, it could open up more opportunities abroad as working restrictions are lifted.

Although the Baltic states of Estonia, Latvia and Lithuania have high unemployment rates they also have the fastest rate of growth of GDP (Gross Domestic Product). In addition to the accession countries there are three applicant countries and a further 17 European countries. The latter include Belarus, Moldavia, and the Ukraine, where a high percentage of the population lives in poverty with high unemployment and underemployment, ie higher qualified workers carrying out lower skilled jobs.

The OECD countries
The Organization for Economic Co-operation and Development (OECD) has 30 member countries. The members include all of the 15 pre-accession EU states, four of the accession countries, one applicant country and three of the remaining European countries. The other seven countries are Australia, Canada, Japan, Korea, Mexico, New-Zealand and the United States.
Of this group, SMEs represent over 95% of enterprises in most countries and generate over half of private sector employment. In New-Zealand, for example, nine out of ten businesses

employ less than ten people. IT is of particular importance, with the number of employees in this area in 2003 more than doubling that of 1997.

Most OECD governments promote entrepreneurship and develop SMEs with a myriad of policies and programmes. As in the EU, this is to combat SME difficulties such as financing, technology and innovation, e-commerce, management and internationalization. For example, in Korea measures include tax breaks and reduced interest loans for starting new businesses in rural areas.

In America, small business benefited from about US$2 billion in the financial year of 2003, approximately 20% of total authorizations. In value terms, almost 23% of the contracts reported were awarded to small businesses; about a third of these were to small disadvantaged businesses. Procurement policy also seeks to increase the participation of small businesses, veteran-owned small businesses, small disadvantaged business, and women-owned small businesses. The Small Business Act (P.L. 85-536), as amended, requires that each contract with an anticipated value greater than US$ 2,500 but less than US$ 100,000 be reserved exclusively for small business concerns unless the contracting officer is unable to obtain offers from two or more small businesses that are competitive with market prices and with the quality of the goods or services to be purchased.

Rest of the world

Latin-America: After focusing on large investments and wooing multinationals for years, Latin American politicians are beginning to realize that SMEs are the true job creators, as well as important players in technology supply chains. The vast majority (approximately 80-90%) of companies are micro enterprises and the governments have vastly reduced red tape to ensure SMEs needs are attended to swiftly. Among the major regional economies, only Argentina experienced a drop in the number of SMEs between 1998 and 2002, while these types of businesses flourished elsewhere in Latin-America, especially in Brazil and Mexico. While in Brazil the economy expanded by only 0.8% in 1999, SMEs grew by 6.5%. In Colombia, SMEs now account for 36% of all jobs and 63% of industrial jobs. Moreover, SME membership in Colombia's chambers of commerce rose from an average of 20% in 2000 to 93% in 2002.

Asia: 'It has been recognised that some of the world's best performing economies, notably Taiwan and Hong Kong, are very heavily based on small enterprises'. 81% of all employment in Japan is in SMEs where the average enterprise employs nine staff as opposed to four in the EU.

South Africa: 'South Africa: as in Latin America, the share of employment located in the micro, small and medium sectors taken together is high – estimated recently at 60% while the sector generated about 40% of output'. (Government of South Africa, 1999)

The Developing World

The International Finance Corporation states (see Figure 1): 'in much of the developing world the private economy is almost entirely comprised of SMEs' and that 'they are the only realistic employment opportunity for millions of poor people throughout the world'.
Some experts explain that 'a significant section of SMEs in developing countries remains in traditional activities generally with low levels of productivity, poor quality products, serving small, localized markets. There is little or no technological dynamism in this group, and few 'graduate' into large size or modern technologies. In many poor countries, there is also a large underclass of (formal and informal) micro enterprises that ekes out a bare survival'.

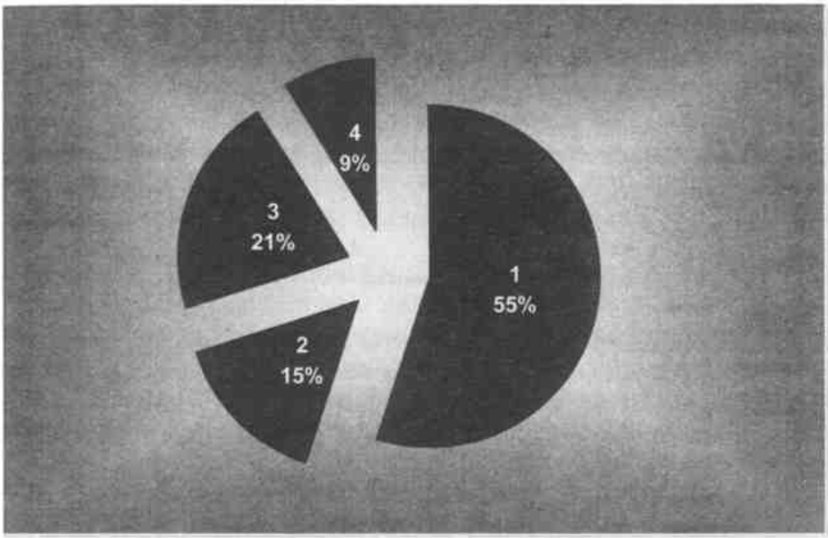

Figure 1. World Bank Group SME Investments
Fiscal Year 2004 Approvals in USD

1. Internatioanl Finance Corporation (IFC) $ 820 million
2. Multilateral Investment Guarantee Agency (MIGA) $ 219 million
3. International Bank for Reconstruction and Deveelopment (IBRD) $ 317 million
4: International Devevlopment Association (IDA) $ 141 million

Source: 2004 Annual Review Small Business Activities
International Finance Corporation; World Bank Group
www.ifc.org/sme

What do SMEs need for success?

The globalisation of business has increasingly drawn SMEs into global value chains through different types of cross-border activities. Many entrepreneurs are recognizing the opportunities that this process offers and gaining access to global markets has become a strategic instrument for their further development. Access to global markets for small businesses can offer a host of business opportunities, such as larger and new niche markets; possibilities to exploit scale and technological advantages; upgrading of technological capability; ways of spreading risk; lowering and sharing costs, including R&D costs; and in many cases, improving access to finance. Gaining access to global markets can help prospective high-growth firms realize their potential and is often an essential strategic move for SMEs with large investments in intellectual property.

To prosper, SMEs need a conductive business environment and regulations, adequate basic infrastructure services, access to short and long-term funding at reasonable rates, equity and venture capital, advisory assistance, and knowledge about market opportunities. They typically suffer from weak entrepreneurial skills as well as deficiencies in accounting, production management, and business planning. As SMEs grow, they increasingly need connectivity to export markets and the world economy.

So far, the lessons of international experience show that very few government and donor initiatives have succeeded in implementing sustainable strategies for SME development. To succeed, sustainable SME development will require concerted efforts among the various parties concerned including commercial and rural banks, leasing companies and equity providers, consulting and training firms, internet providers, as well as local business associations.

Governments' role in the process should be limited to providing the enabling environment for private sector development, correcting potential market failures and creating a level-playing field that will allow SMEs to compete with their larger counterparts on an equall basis. Governments do not have the finances nor the ability to get involved directly in economic activities such as SME financing and service provision. Emerging international experience is demonstrating that government is not the appropriate vehicle to implement and coordinate such efforts, and that public-private partnerships for SME development are a critical element for the success of these efforts.

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